No. 12539.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

A. BRIGHAM ROSE and ZELLETTA ROSE; LORI, LTD., INCORPORATED: ZELLETTA M. ROSE and A. BRIGHAM ROSE,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONERS' REPLY BRIEF.

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PETITIONERS' REPLY BRIEF.

Introductory Statement.

Petitioners in this introductory statement examine into the general structure, content and apparent purpose of respondent's brief. They do this with considerable hesitancy, and not a little trepidation, but they assure the Court that their only purpose is to enable the Court better to understand their own argument and that of respondent.

Petitioners in their opening brief pointed out specific errors made by the Tax Court. In each case the item involved was precisely stated, with precise citation to the

record. It was petitioners' aim to bring light to the record, so that this Court could see each item in clear relief.

But respondent has obviously a different purpose. With two minor exceptions, which will be noted in the course of this brief, respondent's entire argument, spread over 57 pages of more than 400 words to the page, is a mass of vague generalizations, distortions, and irrelevant citations. Respondent complains again and again of the contradictions and confusion in the record. (Br. 35-36, 38, 49, 50-52, 55, 63, 67, 70, 80-81.) That record, however, is in no small part respondent's own product. Certainly now he makes no effort to sharpen or illuminate any part of it. His primary effort appears rather to confound and confuse. It is obviously his purpose, convinced that petitioners' case will flourish in the light, to pour darkness upon the record, in order that petitioners may be empaled upon their burden before this Court.

It is clear also that the length of respondent's brief and the time which they took to write it resulted primarily from their total failure to explain away their own Exhibit S. Petitioners would be willing to stake their entire case upon that exhibit. They will in this brief, nevertheless, examine each part of respondent's argument, following the order of the subjects in respondent's brief.

I.

Respondent Fails to Support the Prima Facie Correctness of His Determinations When He Relies Primarily on Obviously Erroneous Net Worth Computations.

Respondent, under point I, pages 27-36, of his brief, opens his argument with a detailed and exhaustive effort to sustain the *prima facie* correctness of the Commissioner's deficiency determinations, a subject which petitioners treated under point XI, pages 37-39, of their opening brief.

Petitioners reaffirm all of the contentions made on that point in their opening brief. They now have one to add, brought out by point I of respondent's brief, and that is the Commissioner's reliance to a controlling extent in his deficiency determinations upon an erroneous reading of Exhibit S, which consists of financial statements showing the increases in petitioners' net worth. So great was his error in his reading of that exhibit that, in another part of his brief, point III, he now attempts to disown it. That error alone, even if there were no others, is sufficient to overcome the presumption of correctness of the Commissioner's determinations.

In the course of his argument on the subject of that presumption respondent states at several points that his deficiency determinations were based on increases in the petitioners' net worth. We quote:

> "Accordingly, the question presented in respect of each of the taxpayers is whether the Tax Court properly found, upon all the evidence, that they failed, in large part, to overcome the presumptive correctness of the Commissioner's determination that the

amounts of their taxable income realized for the years 1938 to 1941, inclusive, were, *on the basis of the increases ascertained in their net worth,* not less than the sums upon which the respective deficiencies were computed." (Br. 28. Italics added.)

"In the absence of such records and assistance, however, the Commissioner determined the *net worth* of each of the taxpayers as of the beginning and end of each taxable year. [R. 436-440, 445; Exs. N, O and P.]" (Br. 32. Italics added.)

"As to the community net income of the individual taxpayers, Rose and his wife, the Commissioner subtracted from the increases in their *net worth* ascertained for each year all the allowable identified deductions, as business expenses, transfers between the various bank accounts, charge-back by the banks, divers and sundry payments to others, etc. He added thereto amounts considered reasonably sufficient to cover the taxpayers' personal, living and family expenses, not otherwise reflected in the computations. Section 24(a)(1), Internal Revenue Code (Appendix, *infra*). He thereby, upon appropriate adjustments made, arrived at their community net income and the resulting deficiencies asserted for each year. [R. 397-400, 436-440, 442-443, 449-450; Ex. N.] In so doing, 'No reasonable doubts were resolved against the taxpayer, while the audit and analysis made by the Commissioner seems to have been made as accurate as the circumstances here permitted.' Halle v. Commissioner, 175 F. 2d 500, 502-503 (C. A. 2d), certiorari denied, 338 U. S. 949. It is significant, moreover, that the increases in the taxpayers' individual *net worth* and their total community net income as thus determined by the Com-

misioner and redetermined by the Tax Court for the taxable years, while substantial, were far less than those shown by taxpayer Rose himself in his annual statements of financial condition, submitted to his bank for credit purposes, covering substantially the same period involved here. [R. 444, 450-451; Ex. S; Pet. Br. 15-21.]" (Br. 34. Italics added.)

Respondent in the same connection cites multitudinous authority in support of the net worth method. Again we quote:

"In many cases where taxpayers, engaged in business, have failed to keep proper books of accounts and records of income-producing transactions, the courts have sustained the Commissioner's determinations of income *upon the basis of the increase in the taxpayer's net worth* for each year under review, and adding thereto a reasonable estimated amount, not reflected in such increase, to cover personal and living expenses. *Roberts v. Commissioner*, 176 F. 2d 221, 226 (C. A. 9th); *Carmack v. Commissioner*, 183 F. 2d 1 (C. A. 5th), certiorari denied, 340 U. S. 875; *Burka v. Commissioner*, 179 F. 2d 483, 484-485 (C. A. 4th); *Halle v. Commissioner*, 175 F. 2d 500, 503 (C. A. 2d), certiorari denied, 338 U. S. 949; *Mazzacone v. Commissioner*, decided May 20, 1948 (1948 P-H T. C. Memorandum Decisions, par. 48,084), affirmed *per curiam*, 175 F. 2d 778 (C. A. 3d); *Harris v. Commissioner*, 174 F. 2d 70 (C. A. 4th); *Stinnett v. United States*, 173 F. 2d 129 (C. A. 4th), certiorari denied, 337 U. S. 957; *Jelaza v. United States*, 179 F. 2d 202, 203 (C. A. 4th); *Kenney v. Commissioner*, 111 F. 2d 374, 375 (C. A. 5th); *Hoefle v. Commissioner*, 114 F. 2d 713, 714 (C. A. 6th); *Brodella v. United States*, 184 F. 2d 823, 824-

825 (C. A. 6th); *Hague Estate v. Commissioner,* 132 F. 2d 775, 777-778 (C. A. 2d), certiorari denied, 318 U. S. 787." (Br. 31-32. Italics added.)

The only evidence in the record—absolutely the only evidence—showing net worth or increases in net worth is Exhibit S. No other exhibit, whether or not cited in the above quotations, no part of the testimony except that identifying the said Exhibit S [R. 89-91], no part of the findings and opinion except those relating to the said Exhibit S [R. 444, 450-451], makes any reference whatever to net worth or increases in net worth. Yet since this very exhibit, introduced into evidence by respondent, is now the major basis of petitioners' case, respondent contends in a different part of his brief, point III (Br. 41-44), that a correct application of that exhibit cannot now be made because, and again we quote:

"First, this issue was neither alleged in the taxpayers' petitions for redetermination of the deficiencies involved [R. 7-10, 498-505, 513-524], nor was it presented to or considered by the Tax Court [R. 426-455]. Neither was it assigned as error [R. 544-546], nor included in the taxpayers' statement of points intended to be relied on upon review [R. 549-560]. Consequently, this Court is not called upon to decide the issue but, under the authorities, is duty bound to pass it." (Citing numerous cases. Br. 41-42.)

It will be shown herein under point III that the above statement is wholly erroneous. The only purpose of quoting it here is to show that while respondent rests the *prima facie* correctness of his computations on the net

worth method, he disowns, in another part of his brief, and contends this Court is duty bound to pass, *the only evidence* bearing on petitioners' net worth and the increases therein.

Next under point III, respondent, recognizing that this Court might nevertheless consider the evidence contained in Exhibit S, contends as follows:

> "Contrary to the taxpayers' contention that the statements in question were adduced in evidence by the Commissioner *in corroboration* of his determinations of their increases in net worth, the fact is, of course, that they were introduced merely for *comparative* purposes as showing the taxpayers' phenomenal increase in wealth [R. 444, 450-451; Ex. S, pp. A-3 and A-9], far beyond the aggregate income disclosed by taxpayer Rose and wife in their tax returns [Exs. E-J], as well as that redetermined by the Tax Court (Pet. Br. 20)." (Br. 42.)

Since Exhibit S is the *only* evidence of petitioners' increases in net worth, obviously it was not introduced by the Commissioner for the purpose of *corroborating* his determinations of petitioners' increases in net worth. Nowhere in their brief do petitioners say that it was. And if, as respondent now contends, the Commissioner introduced Exhibit S, not *"in corroboration"* but *"merely for comparative purposes,"* may it not be proper to inquire what the *comparison* is for in this case if not to *corroborate* something.

Thus respondent has attempted to disown, and if not successful in disowning, at least to belittle, his own evidence and his *only* evidence in respect of petitioners'

increases in net worth. Yet his entire argument in support of the *prima facie* correctness of his determinations is that perforce they were based on evidence of increases in net worth and that the net worth method has in numerous cases been accepted as valid. All there is otherwise of his 10-page answer to petitioners' 2-page argument against the presumption of correctness of the Commissioner's determinations in this proceeding is the following:

> "There is no basis in the record for these contentions." (Br. 29.)

In their short statement on this issue, petitioners cited 4 cases and quoted from 2 of them. In his lengthy answer on this issue—5 times as long in number of pages and 8 times as long in number of words—respondent cited 29 cases but failed to make even a single reference, by way of distinction or otherwise, to one or more of the cases cited by petitioners. The reason is obvious. Respondent's reply is but an elaborate evasion, a compound of irrelevant argument and irrelevant authorities. Its only pertinence lies in its content of statements showing his reliance in his deficiency determinations on Exhibit S, despite his effort in another part of his brief to disown it. Petitioners submit again, as they did in their opening brief, page 39, that the Tax Court should have granted petitioners' motions for rehearing, that it should have disregarded the Commissioner's deficiency determinations, and should have made an independent redetermination of the net income of petitioners.

II.

The Proof Is Clear That the Commissioner and the Tax Court Erroneously Included in Rose's Gross Income, by Way of the Disbursements Out of the Lori Account, Monies Borrowed by Rose and Deposited in the Lori Account, and Fees of His Deposited in That Account but Elsewhere Included in His Gross Income.

We come now to the Tax Court's inclusion in the gross income of Rose, of all disbursements by Lori to him, for his account, or unexplained, without at the same time deducting the amounts of said disbursements made out of his own monies deposited in the Lori account. This subject is covered by respondent in point II, pages 36-41, of his brief, and by petitioners in point I, pages 10-14, of their opening brief.

Respondent erroneously assumes that Rose "does not dispute the item of $15,873.23 thus included in his income by the Commissioner" for 1938. (Br. 37.) Apparently this same erroneous assumption is made in respect of the other years. As it will be seen under point III herein, petitioners dispute the entire structure of the Commissioner's determinations. We are concerned here, however, only with these specific amounts included in Rose's gross income, to the extent to which they represent Rose's own money, where such money was either (a) non-income or (b) income elsewhere included.

The non-income amounts consist of monies borrowed by Rose totaling $3,500 for 1939, $1,456.76 for 1940 and $5,805.32 for 1941. Respondent concedes that the loans specified were made by Rose and that like amounts "were *concurrently* deposited in Lori's account." (Br. 37. Ital-

ics added.) The Tax Court found that Rose used all of the bank accounts in his own name, "as well as the Lori account, for his personal deposits and expenditures. . . ." [R. 431.]

But respondent strains for a different explanation of these deposits. They might, he says, represent taxable transactions. (Br. 37.) What possible taxable transactions they might represent he does not suggest. Other than this bank account the record shows nothing whatever in Lori's name except the Villa Courts, and no operations of any kind in its name except in connection with the Villa Courts. The beneficial owner of the Villa Courts was Rose [R. 433, 441], and throughout the entire 4-year period involved those courts were never sold. [R. 432-434.] Yet respondent suggests that perhaps the loans made by Rose, with deposit of identical amounts, in each case on the very same day, in the Lori account, an account which he used for "his personal deposits and expenditures," might represent taxable transactions.

Respondent suggests also that these deposits might be monies he owed Lori. (Br. 37.) For what? If Rose borrowed money from Lori, then the payments by Lori to him as such loans should be excluded from the totals of Lori disbursements included in his gross income. Either way the result is the same.

Respondent suggests one other possible explanation of these deposits. He says there is no showing that Rose, upon depositing these amounts in the Lori account, "did not thereafter continue to draw checks in smaller amounts against such total deposits for his own purposes until the

full amounts thereof were exhausted." (Br. 37.) Of course he drew such checks. But these very checks, as shown in petitioners' opening brief, pages 10-14, were included in arriving at the totals of Lori disbursements included in Rose's gross income. It is just that of which we complain. Just because Rose used the Lori account in which to deposit these borrowed monies and then pay them out for various purposes of his own does not justify including the payments so made in his gross income. Clearly the additions to Rose's gross income based on total payments out of the Lori account to him or for his benefit should be reduced by the amount of such borrowed monies.

Respondent makes a similar mistake as to the income item of $6,500. He says that this amount was part of a legal fee of $17,500. (Br. 39.) True, but the $17,500 was separately included *in its entirety* in respondent's computation of Rose's gross income. [R. 438.] Nowhere was the $6,500 deducted. Yet, in precisely the same manner as in connection with the loans explained above, that amount was deposited in the Lori account and the disbursements therefrom were included in the totals of Lori disbursements included in Rose's gross income. As a result, the $6,500 was included in his gross income twice, once as a part of the $17,500 fee and again as a part of the Lori disbursements.

We should also like to note that in the course of his argument under this heading respondent makes the assumption that the $17,500 fee was not taken into consideration by Rose in computing the net income reported on his returns. (Br. 39.) Respondent's only citation therefor is the 1939 return, Exhibit F, which lends no support to that assumption. It appears clear now that the contrary of that assumption is true. The Commissioner

himself, including in Rose's professional income for 1939 this $17,500 fee and all of his bank deposits except transfers from the Lori account, was able to increase Rose's professional net income for that year over the amount thereof shown on his return by only $8,195.90. [R. 527.] The bank deposits in total were $30,698.96 [R. 438], and the transfers from the Lori account excluded therefrom, $12,299.65 [R. 438], leaving a net total of $18,399.31, which the Commissioner added to the $17,500 fee to determine Rose's gross professional receipts for 1939. [R. 528.] Still the Commissioner came out with an increase for that year of only the said amount of $8,195.90 in Rose's professional net income. The Commissioner, it is true, increased Rose's 1939 income also by $17,776.63 as derived from Lori deposits [R. 439], but the Tax Court allowed $10,972.15 against this [R. 441—total of the items shown under 1939], and clear duplications of another $10,000 are shown in petitioners' opening brief, page 12, so that actually the Commissioner should have deducted $3,195.52 instead of adding $17,776.63 in respect of income from the Lori deposits. Rose therefore must have taken the $17,500 fee into consideration in making up his returns. Either it was included somewhere in the deposits or otherwise added in.

We come now to an exception which proves the rule. In respect to the item of $1,200 pointed out by petitioners in their opening brief, pages 13-14, petitioners concede error. Respondent correctly observes that in computing Rose's professional income from Rose's deposits the Com-

missioner allowed a deduction for the 1941 salary of $1,200 as "salary from Lori assumed to be in deposits." (Br. 39.) We should like to point out, however, that petitioners' error in that respect resulted from a variance as between 1940 and 1941 in the Commissioner's handling of that item. In the Commissioner's computation of Rose's professional income the amount of that salary item, $1,200, was excluded for both 1940 and 1941. [R. 438.] However, this was offset for 1940 by reducing the deduction for "transfers from Lori bank acct." from $2,681.90 [R. 14] to $1,481.90. [R. 438.] No similar offset was made for 1941. The transfers from the Lori account of $2,-616.00 [R. 530] were deducted in full. [R. 438.] As a result, for 1940, the exclusion of this salary item was made by the Commissioner in the computation of Rose's non-professional income [R. 14], and for 1941, in the computation of his professional income. [R. 438.] Petitioners noted the exclusion for 1940 [R. 14], and failing to find the 1941 amount excluded in the corresponding computation for that year, assumed that it was not made. Petitioners nevertheless apologize for complaining in respect to that item.

The other adjustments requested by petitioners under point I of their opening brief, pages 10-14, being $10,000 for 1939, $1,456.76 for 1940, and $5,805.32 for 1941, stand completely untouched by respondent's answer. These are clear and specific errors in the Commissioner's computation. Petitioners submit again that they must be allowed.

III.

The Financial Statements on Which the Tax Court Relied but Which It Misread Show the Tax Court's Redeterminations to Be Erroneous and the Petitioners' Returns to Be Correct.

As it was observed under point I herein, respondent in his attempt to sustain the *prima facie* correctness of his deficiency determinations stated again and again that those determinations were based on petitioners' increases in net worth. This is even true of respondent's summary of argument under that point. There he states:

> "They have failed to meet such burden. The Commissioner determined and the Tax Court redetermined the taxpayers' income by ascertaining the total increases in their net worth, and adding thereto estimated reasonable amounts, not reflected in such increases, to cover their personal and living expenses." (Br. 20.)

As it was further observed in point I herein, respondent's Exhibit S is the sole evidence of increases in net worth. Indeed, it is also the sole evidence from which "estimated reasonable amounts" to cover Rose's "personal and living expenses" can be determined. Yet respondent under point III attempts to disown Exhibit S, contending that it was an "issue" not raised in the Tax Court, and that in consequence this Court is "duty bound to pass it."

Exhibit S is not an issue; it is a piece of evidence introduced in the Tax Court by the Commissioner himself, and all that petitioners now ask is that it be read correctly. If the Tax Court's misreading of that exhibit be an issue then obviously that issue could not have arisen

until after the Tax Court had rendered its opinion. That opinion was rendered January 6, 1949 [R. 4], and a copy thereof was served January 7, 1949. [R. 4.] On Monday, February 7, 1949 [R. 4], within the 30-day period allowed by Rule 19(e) of the Tax Court's rules (as amplified by Rule 61 thereof as to computation of time), a motion for rehearing was filed in the Tax Court. As that motion will show, it was filed by present counsel for petitioners and was his first act in this proceeding. His appearance was filed separately on February 14, 1949. [R. 4.] That motion contains *inter alia* the following statement:

> "C. The Court has sustained the respondent's allegation of fraud principally on the basis of certain statements presented by petitioners to the Citizens Bank. (Memorandum Findings of Fact and Opinion, page 18.) *The increases in net worth reflected by the said statements were determined on the basis of accrual and current valuation, whereas the income tax returns reflect only income fully realized in cash or its equivalent. The Court's findings wholly fail to consider this point.* Petitioners are prepared to present evidence in respect to said statements showing their consistency with the allegations made by them in this proceeding."* (Italics added.)

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*Petitioners assume that they are entitled to make reference to this motion for rehearing, which is included in the record before this Court but is not a part of the printed record, under the order to allow reference to documents without printing. [R. 565-7.] If they are not so entitled they now ask leave to have it printed as a supplement to the printed record. Of course, respondent has a copy of the document since a copy was necessarily served upon him by the Tax Court, and he can check the accuracy of petitioners' quotation.

Clearly then this issue was presented to the Tax Court. In *Bell v. Commissioner*, 139 F. 2d 147 (1943), the Court of Appeals for the Third Circuit stated, at page 148:

> "The Commissioner stresses that the petitioner raises the pertinency and applicability of Sec. 112 (b)(5) for the first time in this court on his pending petition for review of the Tax Court's decision. Such, however, is not exactly the situation. It is true that Sec. 112(b)(5) was not relied upon by the taxpayer either in his petition from the Commissioner's determination or at the hearing thereon before the Tax Court. It is also true that neither party brought that provision of the Revenue Act or the Supreme Court's construction thereof in the *Cement Investors* case to the attention of the Tax Court prior to its decision. *However, the petitioner did move timely for a reconsideration of the Tax Court's decision and specified as the reason for his motion the pertinency of Sec. 112(b)(5). In that way the point now advanced by the petitioner was raised below*; and the Tax Court terminated the matter by entering an order denying the petitioner's motion for a reconsideration of the decision.
>
> "This is not a case of a party who, unsuccessful below, 'add(s) here for the first time another string to his bow.' (*Cf., Helvering v. Wood,* 309 U. S. 344, 349.) Even that may be done where there has not been an express waiver of the ground later advanced. See *Hormel v. Helvering,* 312 U. S. 552, 557-559. We think that, under the circumstances here shown, Sec. 112(b)(5) is presently available to the petitioner." (Italics added.)

Considering especially the fact that here the issue involved, if it can be called an issue, is the Tax Court's incorrect reading of an exhibit introduced at the trial by

the respondent, an issue therefore which could not have been raised before the Tax Court, except by motion filed after that court's opinion had been rendered, it must be clear that such issue was timely raised.

We should like to note next a misinterpretation by respondent in this connection of petitioners' opening brief. Respondent says:

> "Hence, in so far as the record shows, the taxpayers' returns grossly understating their taxable net income by more than $41,800 (Br. 20), must necessarily be incorrect to such extent at least." (Br. 43.)

Petitioners are completely unable to determine where such a statement appears on page 20 of their opening brief. Apparently the figure of $41,800 refers to the difference of $41,833.45 between the following two amounts appearing at the bottom of the said page 20: (1) the total of $37,706.61 reported by the petitioners as net income for the four years involved, and (2) the total of $79,540.06 redetermined for those years by the Tax Court. But nowhere does petitioners' brief say that the taxpayers' returns understated their net income by that amount. Obviously also respondent is begging the question; it is that very difference between the taxpayers' returns and the Tax Court's redetermination which petitioners are contesting in this proceeding.

Coming now to the merits on this point, we are no longer concerned with whether the Commissioner used Exhibit S "in corroboration" of anything, or for "comparative" purposes. We are concerned with what Exhibit S shows. Respondent in regard to the statements contained in that exhibit, says:

> "The statements disclose an aggregate increase in taxpayer Rose's net worth of $75,000 and total in-

come of $85,300 for the four-year period involved, and they were certified by taxpayer Rose 'as being a full, true and correct statement of * * * [his] financial condition on the date given,' and 'to be true and correct to the best of my knowledge and belief.'[11] [Ex. S, pp. A-3 to A-9; R. 444.] As against such admitted total income, the Tax Court redetermined the community net income of taxpayers Rose and wife to be only the total sum of $79,540.06 for the entire four years involved [R. 455-456, 512-513, 541; Pet. Br. 20]. The taxpayers, however, departing from Rose's *certified* statements currently submitted to his bank during those years, reported only $37,-706.61 as their entire community net income for such period, a difference in excess of $47,500 from that shown by the statements (Pet. Br. 20-21)." (Br. 42-43.)

The footnote indicated reads as follows:

"[11]It must be assumed, we submit, that taxpayer Rose's certified statements submitted to his own bank from year to year represented his *true* financial condition for the four-year period involved for, as the Tax Court pointed out [R. 450-451], the falsification of such statements constitutes a crime under California law. See Section 532 ('False Pretenses', etc.) and Section 532a ('False Financial Statements', etc.) of Deering's Penal Code of California (1949)." (Br. 42.)

It is clear, however, that the total of $79,540.06 arrived at by the Tax Court, and of $37,706.61 shown by the taxpayers on their returns, as the net income of Rose and his wife for the four years involved, were determined on a cash basis. [R. 428.] It is equally clear that the total income of $85,300 for the same period shown by the

statements contained in Exhibit S was determined on the accrual basis. Respondent does not question this fact. (Br. 43.)

It is not at all uncommon for a taxpayer to use the cash basis for tax purposes and the accrual basis for credit purposes. Nor is it in the slightest improper. The differences between accounting and business practice on the one hand, and principles applicable under the income tax laws on the other, are so numerous that books have been written on the subject. See, for example, "Differences in Net Income for Accounting and Federal Income Taxes," by Clarence F. Reimer, Ph.D., C.P.A. For articles on the subject, see "Tax Accounting Compared with Recognized Accounting Principles," by Paul D. Seghers, National Tax Journal, Volume I, No. 4, December, 1948; also, "Tax Accounting vs. Commercial Accounting," by J. K. Lasser and Maurice E. Peloubet, Tax Law Review, Vol. 4, No. 3, March, 1949, page 343.

The courts have also taken cognizance of this situation in many decisions. Thus, in *Spring City Foundry v. Commissioner,* 292 U. S. 182, 54 S. Ct. 644 (1934), the Supreme Court stated, 292 U. S. at p. 189:

> "Petitioner insists that 'good business practice' forbade the inclusion in the taxpayer's assets of the account receivable in question or at least the part of it which was subsequently found to be uncollectible. But that is not the question here. *Questions relating to allowable deductions under the income tax act are quite distinct from matters which pertain to an appropriate showing upon which credit is sought.*" (Italics added.)

Again, in *Commissioner v. Phipps*, 336 U. S. 410, 69 S. Ct. 616 (1949), the Supreme Court stated, 336 U. S. at p. 420:

> "It is urged upon us that the deficits of the subsidiaries should be subtracted from the earnings and profits of the parent in order to make the tax consequences of the liquidation correspond with corporate accounting practice. The answer is brief. The *Sansome* rule itself, as applied to earnings and profits, has never been thought to be controlled by ordinary corporate accounting concepts; its uniform effect is to treat for tax purposes as earnings or profits assets which are properly considered capital for many if not most corporate purposes, and it has long been a commonplace of tax law that similar divergencies often occur. See *Commissioner v. Wheeler*, 324 U. S. 542, 546; *Putnam v. United States*, 149 Fed. (2d) 721, 726, 1 Mertens, op. cit. Sec. 9.33; Rudick, op. cit. 878-906."

And in *Weiss v. Wiener*, 279 U. S. 333, 49 S. Ct. 337 (1929), the Supreme Court stated, 279 U. S. at p. 335:

> "The income tax laws do not profess to embody perfect economic theory. They ignore some things that either a theorist or a business man would take into account in determining the pecuniary condition of the taxpayer."

Clear it is then that Rose placed himself in no conflict with either the federal income tax laws or the Penal Code of California because he prepared his tax returns on a cash basis and his statements for credit purposes on the accrual basis. For respondent to make this contention in the face of a practice so well accepted but emphasizes the frailty of his entire argument.

Now as to what Exhibit S in fact shows, respondent's extremely short answer—a single page out of his entire 93-page brief—is entirely without substance and even without any discernible meaning. He says that "the last of Rose's financial statements coming within this four-year taxable period involved here was the third one which he submitted to his bank on March 1, 1940." (Br. 43.) Then why does he say on the very page preceding that the "statements disclose an aggregate increase in taxpayer Rose's net worth of *$75,000* and total income of *$85,300* for the *four-year* period involved, . . .?"(Br. 42. Italics added.)

Assuming, nevertheless, that the March 1, 1940, statement is the last one, what does it show? Respondent concedes that it shows accounts receivable, less accounts payable, in the net sum of $31,250. (Br. 43.) The corresponding amount on the statement for June 11, 1938, is $5,900, so that during the intervening period of less than two years there was an increase in income accrued but not received of $25,350. The three financial statements "within" the taxable period involved show his annual income as follows [R. 444]:

6-11-38		$13,500.00
4-29-39	(in excess of)	10,000.00
3- 1-40	(in excess of)	20,000.00

If one takes those amounts on any consecutive two statements, the most that one has for income for a two-year period is $30,000. Deduct the increase of income accrued but not received between 6/11/38 and 3/1/40, $25,350 as computed above, *and all one has left on a cash basis for the two-year period is $4,650.* Now let us see what the *taxable net income* of Rose and his wife was for substantially the same two-year period, 1938 and 1939,

as shown by the returns, as determined by the Commissioner, and as redetermined by the Tax Court:

		Per Returns*	Per Deficiency Notices*	Per Tax Court Decisions**
1938		None	$26,374.72	$ 8,203.21
1939	A. Brigham Rose	$3,039.92	17,871.36	10,925.28
	Zelletta M. Rose	3,039.92	17,871.36	10,925.28
		$6,079.84	$62,117.44	$30,053.77

*R. 440.

**The detail appears only in respondent's computation for entry of decision, filed April 12, 1949 [R. 4], in petitioners' statement of points [R. 555], and in petitioners' opening brief, page 20. The said computation of entry of decision is expressly within the order allowing reference to documents without printing. [R. 566.]

No matter how one compares these statements the results are clear. Whether one takes all four statements which the Tax Court cited and on which it relied, that is, the statements dated 6/11/38, 4/29/39, 3/1/40, and 9/21/42 [R. 444], or only the first three of them, as respondent prefers (Br. 43), it is clear that petitioners' returns were right and the Commissioner and the Tax Court were wrong—not only wrong, but so far wrong as to have no semblance of relation to the truth.

The acme of respondent's argument on this point, however, is his following statement:

> "Moreover, *no* accounts receivable are shown for the last taxable year (1941) involved here. [R. 444; Ex. S, p. A-7.] Quite plainly, therefore, the last statement Rose submitted to his bank on September 21, 1942, disclosing accounts receivable of $50,000 *on that date,* does not establish or show *any* accounts receivable for the last taxable year involved here. [R. 444; Ex. S, p. A-9; Pet. Br. 15-21.] Even if adjustment of that statement to the cash basis would

> make any difference tax-wise, there is no such statement in evidence covering the last taxable year and, consequently, the record showing nothing to the contrary, the Tax Court's redetermination must stand as correct." (Br. 43.)

Does respondent mean to say, or perhaps just imply, that the record represented by "R. 444; Ex. S, p. A-7," no part of which bears any reference to, or indication of, a financial statement dated in 1941, proves that "*no* accounts receivable are shown" for 1941? He may, indeed, only mean that since there is no financial statement dated in 1941 there is no *evidence* of accounts-receivable for 1941. That would be strange, too, since as respondent concedes (Br. 43), the statement for 3/1/40 shows $35,000 of accounts receivable and that for 9/21/42 shows $50,000, and, as the record clearly shows, Rose was in continuous practice during the intervening period. [R. 440.] Also, the Tax Court placed great reliance on the 9/21/42 statement as showing, together with the three preceding statements, Rose's increase in net worth "during the period involved." [R. 444, 451.]

Exhibit S, petitioners again submit, tears down completely respondent's case. Respondent introduced that exhibit, and it is the only evidence which shows the net worth increases upon which he says again and again (Br. 20, 28, 31, 32, 34) his deficiency determinations were based. The Tax Court used that exhibit as a basic factor in its redetermination. [R. 444, 450-51.] Now that that exhibit has turned against respondent he is trying to disown it, and if he cannot do that, then to belittle it, and if he cannot do that, then to distort it. But that exhibit is clear and specific. Petitioners ask that it be treated now, even as respondent has treated it, as the cornerstone of this case.

IV.

Rose's Use of His Own Property, Whether Held in Fee or in Equity, Is Not Income.

Under Point IV, pages 44-46 of his brief, respondent discusses the problem covered by petitioners under their Point VII, page 33, of their brief, that is, the inclusion by the Tax Court in Rose's income of the value of his use of a part of the Villa Courts during the years involved.

On that problem respondent considers only two factors: (1) whether Rose owned the Villa Courts or had "merely an 'equity'" therein, and (2) what the value of the use was. Petitioners never raised any issue in regard to the value of the use. They contested only the includibility. Respondent's argument in respect to the value, beginning in the next to the last line on page 45, followed by his conclusion that the amount was includible, is a clear *non sequitur*, and wholly impertinent.

On the question whether Rose owned the Villa Courts or had "merely an 'equity'" therein, respondent does not explain the difference, nor does he submit a single authority having any bearing on the question. His one-sentence attempt at distinguishing the *Plant* case is likewise wholly without meaning. His argument immediately following on the question of value, tied in misleadingly as a part of his statement in respect to the *Plant* case, but emphasizes his inability to find any basis for distinguishing that case.

Definitely, the value of Rose's use of part of the Villa Courts should not have been included in his gross income.

V.

The Wife's Community Half of Rose's Professional Earnings for 1938 Should Not Be Taxed to Rose Since No Joint Return Was Filed for That Year.

On the question of inclusion in Rose's gross income for 1938 of his wife's community half of his professional earnings, covered by petitioners in Point VIII, pages 34-35, of their brief, and by respondent in Point V, pages 46-48, of his brief, respondent first raises the objection that this issue was not raised in the court below.

As observed under Point III herein, petitioners filed a timely motion for rehearing on February 7, 1949. That motion was denied on May 5, 1949. [R. 4.] On June 8, 1949, and within 30 days after the said denial was served upon petitioners in Los Angeles, petitioners filed, together with and supported by a statement of objections to respondent's computations under Rule 50, a second motion for rehearing. [R. 5.] In the said objections, which were also part of the said second motion for rehearing, under Point VII thereof the issue now being considered was raised in the following language:

> "7. As respondent's computations for 1939 and 1941 show, the entire income of Rose was community income. For 1938, however, respondent included in the income of Rose the total community income. This obviously was improper. In any event, therefore, the income of Rose determined by respondent for 1938 should be cut in half."*

This issue was therefore raised before the Tax Court and considered by it.

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*This document is expressly within the order allowing reference to documents without printing. [R. 566.]

Nor is this Court wholly without power to review an issue solely because it was not raised below. The issue herein involved is one which is obvious on the face of the record and it is unnecessary for this Court to close its eyes to it. In *Hormel v. Helvering*, 312 U. S. 552, 61 S. Ct. 719 (1941), the Supreme Court, distinguishing the case of *General Utilities & Operating Co.*, relied on by respondent here (Br. 47), held that a decision not in accordance with law, even though the issue involved was not raised below, should be modified, reversed or reversed and remanded "as justice may require."

In any event, it is clear here that the issue involved was raised below and is therefore reviewable by this court.

On the merits of this issue, respondent's sole contention is that the 1938 return was a joint return. (Br. 46.) It may be observed, however, that even respondent is not sure of this. In another connection (Br. 75, footnote), he states that fraud was not found against Rose's wife for 1938 because for that year "Rose filed a return *singly* [Ex. E], . . ." (Italics added.)

It is clear in any case that the return was a single return. The election to file a joint return cannot be made by one spouse alone. Section 51(b) of the Revenue Act of 1938, as quoted by respondent (Br. 85), provides that the income of a husband and wife living together "may be included in a single return made by *them* jointly." (Italics added.) Obviously the election must be made by both and not by one. Rose's 1938 return, however, was made solely by him. [R. 429, Ex. E.] Besides, since his wife filed no return for that year (Br. 48), the Commissioner may still pursue her in respect to taxes for that year. (Revenue Act of 1938, Section 276(a).)

As to 1938, the only individual taxpayer involved here is A. Brigham Rose and since his professional income for that year was community income, only one-half thereof belonged to him. (*U. S. v. Malcolm*, 282 U. S. 792.) It follows necessarily that only one-half thereof is includible in his gross income for that year.

VI.

Clear Evidence Shows the Time Rose Acquired the Silver King Coalition Mines Stock as 1936, and Its Basis, the Value When Acquired, as $8 Per Share, or $9,600.

Under Point VI, pages 48-54, of his brief, respondent covers the subject of the Silver King Coalition stock, a subject covered by petitioners under Point IX of their brief, pages 35-36.

Respondent's principal contention under this heading is that Rose did not acquire the stock in 1936, but in 1934. Respondent concedes, however, that what Rose acquired in 1934 was not the stock itself, but "the right to it." (Br. 23, 50.) It would follow from that fact that the stock was acquired by him in 1934 if he were on the accrual basis. (*Spring City Foundry Co. v. Commissioner*, 292 U. S. 182.) But Rose was on a cash basis. [R. 428.] Under that method actual receipt is the determining factor. (*Avery v. Commissioner*, 292 U. S. 210.) As respondent concedes the stock was not actually received by Rose until 1936. (Br. 50.) It necessarily follows that for tax purposes this stock was acquired by him in 1936.

The evidence is clear that at that time the stock was worth $8.00 per share. In quoting from Rose's testimony on this point (Br. 52), respondent omits Rose's final sentence. In respect to what the stock was worth in 1936, that sentence was as follows: "I knew what it sold for." [R. 348, beginning in the seventh line from the bottom.] Rose, therefore, did not just guess at the $8.00 a share; he knew that that was the price for which the stock sold in 1936.

This was the only evidence before the court as to what the stock was worth in 1936. Certainly it was substantial evidence and the Tax Court should have used it. The record is clear that the $4,500.00 figure used by the Commissioner was only the amount of a loan which Rose made against the stock as security in 1947. [R. 298-299.]

And if the stock should be regarded as having been acquired by Rose in 1934, what is the result? The evidence shows that in 1934 an inheritance tax return was filed in which the stock was valued at $10.00 per share. Referring to that return Rose testified—"I filed that." [R. 348.] This $10.00 valuation was clearly then no hearsay. This was the witness' own determination in 1934. The effect is the same precisely as if he had used that determination merely to refresh his memory. If 1934 was the time when the stock was acquired by him the basis should be $10.00 per share and the loss which he deducted should therefore have been increased by the Commissioner in the amount of $2,400.00, and not reduced by him in the amount of $5,100.00, as he did.

VII.

Recorded Encumbrances on the Villa Courts Are Evidence of Their Basis, and Depreciation Should Have Been Allowed Thereon.

Under Point VII of his brief, pages 54-57, respondent covers the subject of depreciation, a subject covered by petitioners under Point X, page 37, of their brief.

Respondent correctly observes that some depreciation was allowed to the individual petitioners by the Commissioner. (Br. 55.) Although the Commissioner made no allowance of depreciation to Lori, he did make an allowance of depreciation to the individual petitioners, at least for the years 1940 and 1941. The amount allowed in each of those years was $168.00. [R. 14, 529.] It may be also that the same amount was allowed for 1939. While the deficiency notice shows an adjustment decreasing the loss from rentals for that year [R. 527-528], the detail of the adjustment is not shown. In any event, petitioners apologize for having failed to note that some allowance was made to the individual petitioners.

As to Lori, respondent's only contention is that there was no evidence of basis. The very clear answer to that contention is that there was good evidence of the basis, as this Court will observe.

Respondent states that Lori has submitted no "acceptable evidence that it owned depreciable assets having a cost value of $32,000,[14] as claimed in its 1940 and 1941 returns." (Br. 55-56.) Footnote 14 referred to in the quoted wording says:

> "Taxpayer Rose's statement to the Tax Court that Lori's Villa Courts property, acquired by others in 1930, had 'record' 'encumbrances in the amount of $38,000.00, augmented by the * * * substantial trust

> funds of the Mary Allen trust (which) went into this property' [Tr. 22, p. 37], of course, can have no significance in respect of the depreciable bases of the property for the taxable years involved here."

The Tax Court in its findings takes note of the record encumbrances referred to. [R. 433.] Those record encumbrances are a part of the cost of the property, *Crane v. Commissioner,* 331 U. S. 1, 67 S. Ct. 1047. Clearly then the Tax Court did have a basis on which to compute depreciation on the Villa Courts. Based on the authorities cited in petitioners' opening brief on this point, the Tax Court should have made an allowance for depreciation on the Villa Courts.

VIII.

Lori Has No Taxable Income of Its Own Since, as Respondent States, Rose Is the Beneficial Owner and Income Is Taxed to the Beneficial Owner of Property.

We come now to the issue as to whether Lori had any income of its own at all. This issue is covered by respondent in point VIII, pages 57-61, of his brief and by petitioners in point III, pages 22-24, of their opening brief. Any discussion elsewhere in this brief involving the taxes imposed on Lori is necessarily subject to this issue.

First, we should like to correct a clear misstatement. Referring to rents collected from the Villa Courts respondent says:

> "This was in excess of $16,240 alone for 1939 [R. 72-73], and it [Lori] had gross income around $25,000 a year [R. 72], as the taxpayers state (Br. 23)." (Br. 59.)

Petitioners made no such statement, either on page 23 of their brief, or anywhere else.

As a main pillar for its conclusions respondent thereafter says:

> "It [Lori] realized taxable net income from its operations in the respective sums of $9,488.13, $8,-167.24, $11,965.17 and $9,239.52, as redetermined by the Tax Court, for the taxable years 1938 to 1941, inclusive. [Tr. 61.]" (Br. 59.)

Of course, this is begging the question. The issue here is whether Lori had any taxable net income at all.

Petitioners do not contend that Lori was not a corporate entity. They contend only that it had no income of its own, that the money and property which appeared in its name did not belong to it, but to Rose.

Respondent himself, attempting to straddle between Lori as owner and Rose as owner, senses his precariousness. In his point I, wherein he attempts to sustain the *prima facie* correctness of his deficiency determinations, he observes that "ownership of the income" is determinative of its taxability; and that as to "the ownership of the income in question, it will be noted that one outstanding fact implicit in the entire record is that substantially all the income of Lori, Brevoort and the other corporate enterprises herein inured to taxpayer Rose's benefit individually, not only during the four taxable years but also thereafter." (Br. 28.) Thereupon respondent rests the *prima facie* correctness of his determination that income "of" Lori, which he taxes to Lori, is "owned" by Rose and therefore taxable to Rose.

Again, in his point IV, dealing with the inclusion in Rose's gross income of the value of Rose's use of a part of the Villa Courts, respondent concedes that Rose had

an equity in the property, but uses quotes around the word "equity" (Br. 22, 45), as if that might in some manner cancel out a part of its meaning or tone down its significance. In fact, he goes so far as to refer to it as *"merely an 'equity.'"* (Br. 45. Italics added.)

Since there were encumbrances against the property [Br. 56, footnote; R. 433], what else but an equity could Rose *as owner* have had in it? Clearly the Tax Court was not exaggerating in the slightest Rose's interest in the Villa Courts when it found that those courts *"were beneficially owned by Rose,* subject to the encumbrances against them and the unliquidated claim of Mary Woods *against Rose";* and that by his expenditures on behalf of Lori, Rose "sought to and did thereby protect and preserve his" equity in the property. [R. 433, 441. Italics supplied.]

Outside of the Villa Courts, the only property which the record shows in Lori's name was a bank account. As to the bank account the result is the same as in the case of the Villa Courts. That account, as the Tax Court found, was used by Rose for his "personal deposits and expenditures." [R. 431.] No funds remained in that account. What came in was paid out. [R. 445.] It was a mere conduit.

Respondent, in his direct consideration of this issue, quotes from the opinion of the Supreme Court in the *Moline Properties* case. (Br. 59.) But the corporation there, as respondent's quotation shows, "engaged in an unambiguous business venture *of its own."* (Italics added.) Here the corporation involved had *no* activities of its own. It was organized merely to *"hold title* to the courts—the bungalows, and villas"—this according to respondent's own witness. [R. 56, italics added.] The

Tax Court implies the same when it shows that Lori's only "activities" were that it "did engage in the business of *holding* real estate." [R. 428, italics added.]

Indeed, as respondent observes, a loan of $7,000 was made in Lori's name from a bank in 1938. (Br. 58.) But Rose and his wife were joint payors with Lori on the note [R. 127]; and the loan was a part of a series of loans which Rose made for his own personal requirements because of the deficiency in his income. [R. 125-127.] While furthermore, the money was deposited in the Lori account, that account, as observed above, was used by Rose for his "personal deposits and expenditures." [R. 431.] Respondent points to no evidence showing that Lori engaged in any venture for its own purposes as distinguished from those of Mr. Rose. The *Moline* case is therefore wholly inapplicable.

The Court in the *Moline* case, moreover, contrary to the effort of the respondent here, does not straddle between the corporation and the stockholder. There the Court stated, 319 U. S. at page 438:

> "The question is whether the gain realized on the 1935 and 1936 sales shall be treated as income taxable to petitioner, as the Government urges, *or* as Thompson's income." (Italics added.)

Here the respondent treats the income as Lori's in the computation of Lori's taxes, and as the income of Rose in the computation of Rose's taxes. It is not without purpose that he speaks of the income "of" Lori as being "owned" by Rose. (Br. 28.)

Respondent is correct when he says that Lori "is chargeable with its own income." (Br. 60.) But that begs the real question here, as to whether the income

received from the Villa Courts or merely passing through the bank account carried in the name of Lori was owned by Lori or by Rose. Rose was the owner of the income here; Lori was a mere agent, nominee, or title holder.

As the *Wilcox* and *Griffiths* cases cited in petitioners' opening brief, page 24, show, this problem must be dealt with realistically. Under the circumstances here we submit again, the income, if any, received in the name of Lori should be taxed to Rose and not Lori.

IX.

The Record Clearly Shows That Rose Paid Expenses of Lori From Monies Received by Him From Lori; and Respondent's Answer That Petitioners Have Failed to Segregate the Expenses as Between the Villa Courts and Brevoort's Hotel Is No Answer Since Income From Both Sources Was Taxed to Lori, Also Without Segregation.

Under point IX, pages 61-66 of his brief, respondent covers the business expenses of Lori paid by Rose in 1938 and 1939, a subject covered by petitioners under point IV of their brief, pages 25-27.

Respondent's contention is mainly that petitioners failed to segregate the amounts involved as between expenses paid on account of the Villa Courts and those paid on account of Brevoort's hotel. (Br. 62, 63, 65.) This contention, however, must fall before the fact that the receipts included in Lori's gross income included receipts from both the Villa Courts and the hotel. Respondent himself observes this fact. (Br. 64, 66.) While the Tax Court did make an allowance to Lori for hotel receipts in 1940 and 1941 [R. 447], it made no such allowance for 1939. As to 1938 it made an aggregate allowance

of $9295.00 covering both "expenses of operation and to adjust gross receipts reflecting both Villa and hotel operations." [R. 447.] But the record does not show that any part of this amount represents an exclusion from Lori income of hotel receipts. [R. 293-296, Exs. 94 and 95.]

The record is clear, on the other hand, that Lori deposits included both Villa Court and hotel receipts and that the expenditures involved here were made by Rose out of the funds received by him from Lori. Since the hotel receipts were included in the Lori gross income there does not appear to be any reason why it is necessary to make any segregation as between the expenses of the hotel and the expenses of the Villa Courts operations in allowing deductions to Lori.* Lori received their receipts and paid their expenses although the payments were made through the bank account of Rose. [R. 441.] It necessarily follows that the payments made by Lori to Rose or for his account during the years 1938 and 1939 and used by Rose for hotel and Villa Court expenses are proper deductions to Lori. The amounts are $10,748.62 for 1938 and $6,107.21 for 1939. [R. 441.]

Respondent suggests the possibility that these expenses should not be allowed as deductions to Lori but rather included as income to it, being expenses paid by Rose

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*The respondent is in clear error in stating that the amount of $508.65 shown in petitioners' opening brief, page 25, is "the identical amount shown as paid by taxpayer Rose on behalf of *Brevoort* for that year [Ex. GG]." (Br. 64.) The exhibit cited clearly shows that that amount was paid on behalf of the Villa Court operations and not Brevoort.

for Lori's benefit. (Br. 66.) Of course, if the amounts paid by Rose on Lori's behalf were treated as constructively received by Lori they would have to, by the same token, be treated as constructively paid by Lori. However, these expenses were not paid by Rose out of his own money but, as the record clearly shows, out of monies received by him from Lori. [R. 441.]

X.

There Should Be Excluded From Lori's Income the Eleven Specific Non-income Items Identified in the Record and Set Out Under Point V of Petitioners' Opening Brief, Not a One of Which Items Is Specifically Challenged in Respondent's Brief.

The issue here involves (a) monies borrowed by Rose as an individual and deposited in the Lori account ($3,500.00, $1,456.76, and $3,200.00 for the years 1939, 1940, and 1941, respectively), and (b) monies transferred from the Rose accounts to the Lori account not representing rentals allocable to the Villa Courts ($1,075.00, $1,500.00, and $1,380.00 for the years 1939, 1940 and 1941, respectively). This issue is covered by respondent under point X, pages 66-70, of his brief, and by petitioners under point V, pages 27-30, of their opening brief.

Petitioners' opening brief shows 11 separate items under this heading and identifies each one specifically in the record. Respondent has failed to challenge a single one of them. In regard to these items petitioners rest upon the statements made in their opening brief.

XI.

Lori Is Entitled to an Excess Profits Credit Since That Issue Was Timely Raised Before the Court Below and Involves Strictly a Matter of Computation.

This issue involves the question whether Lori is entitled to an excess profits credit in the determination of its excess profits tax liability for any of the taxable years involved. This question is covered by respondent under point XI, pages 70-75, of his brief, and by petitioners under point VI, pages 31-33, of their brief.

In the course of his statement under this issue, respondent points out that a case cited by petitioners, *Zimmermann v. Commissioner,* 36 B. T. A. 618, was reversed and remanded on appeal. While petitioners should have noted the fact that the said case was reversed and remanded, the action of the Court of Appeals therein had no connection with the point on which the opinion of the Board of Tax Appeals [now the Tax Court] in that case was cited. The reversal and remand resulted entirely from the intervening decision of the Supreme Court in *United States v. Pleasants,* 305 U. S. 357, on the question whether the losses involved were deductible in arriving at the base for the allowance for contributions. The reversal and remand had no connection with the problem of computation where a mere mathematical adjustment is involved. The point made by the Board in that case has more recently been made by the Tax Court in another case, *Stern Bros. & Co. v. Commissioner,* 16 T. C. No. 40, decided February 8, 1951.

Respondent contends under this heading also that the issue was raised here for the first time. As in the case of the problem of Mrs. Rose's half interest in Mr. Rose's 1938 professional earnings, considered under point V

above, this issue was also presented to the Tax Court in its second motion for rehearing June 8, 1949. As there pointed out, the said motion of petitioners was supported by a detail under the heading of Objections to Respondent's Computations under Rule 50. While the said objections were filed as a part of the motion, the motion was, nevertheless, a motion for rehearing. In the third paragraph of those objections petitioners expressly raised this issue.*

On the merits of this problem respondent's only contention is that there was a lack of proof. Petitioners submit again, as they did in their opening brief, that on the basis of the information contained in the record, this is strictly a question of mathematics and that the computation could and should have been made.

XII.

Petitioners Cannot Be Guilty of Fraud When Errors in the Commissioner's and the Tax Court's Computations Show the Correct Taxable Income to Be Very Close to What the Taxpayers Reported and Where There Was No Intent to Evade Taxes.

This is the fraud issue covered by respondent under point XII, pages 75-84 of his brief, and by petitioners under point XII, pages 40-44 of their opening brief.

Respondent contends here that according to petitioners' opening brief, page 20, petitioners had understated their true income by more than $80,000.00 for the years involved. (Br. 79.) That amount is, indeed, the difference between the net income of the individual petitioners' tax

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*Reference to this document is allowed under the order permitting reference to documents without printing. [R. 566.]

returns and their net income as determined by the Commissioner. It is substantially upon this difference in amount that respondent bases the charge of fraud. The Tax Court itself, however, found that the Commissioner was high by almost $40,000.00. And the difference remaining of $40,000.00 between the Tax Court's results and the petitioners' returns is, as we have already shown, in direct conflict with the Commissioner's own evidence, Exhibit S, which is the only evidence relating to the net worth basis upon which he says the Commissioner made his redeterminations.

Regardless of what the correct net income may be, furthermore, there is no evidence whatever in the record of an intent on the part of these petitioners to evade tax. Upon the record petitioners submit again that a charge of fraud is impossible.

Conclusion.

Petitioners contend, in conclusion, that respondent has wholly failed to meet the issues raised by petitioners; and they submit again that the decisions of the Tax Court should be reversed, with remand, if this Court deems necessary, in respect to any factual issues which must be resolved.

Respectfully submitted,

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